IN THE

Supreme Court of the United States

OCTOBER TERM—1948

No. 237

WISCONSIN ELECTRIC POWER COMPANY,
Petitioner

v.

UNITED STATES OF AMERICA,
Respondent

BRIEF FOR THE CONSOLIDATED EDISON COMPANY OF NEW YORK, INC., AS AMICUS CURIAE

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Review has been asked here as to the construction and effect given by the Court below to the provisions of the Internal Revenue Code which since 1932[1] have imposed upon

> "electrical energy sold for domestic or commercial consumption"

a tax equivalent to the stated percentage of the price for which the energy is so sold. No tax has been imposed on energy sold for "industrial consumption" or on energy sold "for other uses which likewise cannot be classed as domestic

[1] Originally enacted as Section 616 of the Revenue Act of 1932 and continued to-date through re-enactment, amendment as to payment by the vendor of the energy and increase in the percentage, and inclusion in the Internal Revenue Code as Section 3411 thereof. The statute and the Treasury Regulations involved are in the Appendix (pages 25 to 27, *post*).

or commercial" (Regulations 42 (1932 edition) as amended by T. D. 4342 and T. D. 4393 and Regulations 46 as amended by T. D. 5099).

Preliminary Statement

The issue here is as to the rule which the Court below[2] laid down for determining whether the electrical energy sold to a particular consumer at a particular location or locations is taxable as sold for "commercial consumption". The case had arisen as to energy supplied for consumption in the pasteurizing of milk in plants operated by dairies in Wisconsin, but the Court of Appeals placed its decision on the broad ground, not limited or limitable to pasteurization plants, that as a matter of law

> "* * * the proper test to be applied in determining whether the electrical energy used by a particular consumer falls within the term 'commercial consumption' is *whether the predominant character of the business enterprise carried on by the consumer is commercial, irrespective of the particular operations in which the energy is used.* (R. 167)" (italics supplied)

The energy supplied to the dairies and used in the pasteurization of milk was thus held to be sold for "commercial" consumption *because* the dairies were engaged in a business predominantly commercial in character; but such a ruling, if upheld, would extend and apply equally to very many thousands of other situations where energy is sold to enterprises whose activities are principally but not exclusively commercial. The issue therefore arises as to whether or not such a ruling is consistent with the statute, with the Treasury Regulations which have been

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[2] The opinion of the Court of Appeals (R. 166-68) is reported at 168 F. 2d 285. The opinion of the District Court (R. 140-46) is at 69 F. Supp. 743. The judgment of the Court of Appeals is at R. 168. Certiorari was granted October 18, 1948.

left in force unchanged during five re-enactments or extensions of the law, and with the fair and practicable administration of the statute, which would suffer greatly if there were overturned now the classifications of consumption according to Regulations contemporaneous with the enactment of the statute in 1932.

The Solicitor-General's Memorandum on the Petition for Certiorari urged (page 7) that the Court of Appeals had "correctly held" that the energy supplied to a predominantly commercial business is sold for "commercial" consumption, regardless of the nature and purpose of the actual use of the energy, and stated concisely (pages 6-7) in terms of questions of law the two aspects here for review:

> 1. "The District Court concluded as a *matter of law* that the incidence of the tax on electrical energy does not depend upon the particular operation in which the energy is used but upon the business of which it forms a part. * * * The Court of Appeals held that * * * the District Court * * * applied the proper test of commercial consumption."
>
> 2. "*Since* the predominant business of the twenty-seven dairies is, and was, that of fluid milk dealers and distributors, the electricity sold to them by the petitioner was sold for commercial consumption; it was sold and used in a commercial business. (R. 152-153.)" (italics supplied)

We do not think it will be challenged that from its genesis, the statute has based the liability for the tax upon the *consumption*, not the consumer. The taxing law and the Treasury Regulations have not at any time said that the tax should be paid upon all of the energy supplied to a "commercial" consumer (i. e., one whose business is *predominantly* commercial) or that no tax should be paid upon any of the energy consumed in a business that is predominantly industrial. On the contrary, large quantities of energy sold to consumers engaged predominantly in industrial activities have been classified, and have been taxed for

years, as commercially consumed; and much energy sold to predominantly commercial consumers has been classed as non-taxable industrial consumption.

A business *predominantly* industrial, taking into account its many locations and phases, may and does have commercial activities and use electrical energy in them. A business *predominantly* commercial may and does have locations and activities of an industrial character and is sold energy for industrial consumption at such locations. For both classes of consumers, the nature and purpose of the consumption through the particular meter or at the location, not the predominant character of the customer's whole business at all locations, have determined since 1932 what consumption is taxable. Energy supplied to a location for commercial and non-commercial purposes but separately metered, is taxable only as to that commercially consumed. *Only if and where the consumer has only one meter at a location* and receives through it energy for two or more purposes (one of them commercial) has "the predominant character of the business carried on *at such location*" (not at all locations of the consumer's business) determined "the classification of consumption for the purposes of this tax" (T. R. 42 of 1932; Art. 40 as amended by T. D. 4393).

This provision has been in Regulations 42 through every revision of it since 1932 and was adopted with only a minor change in Section 316.190 of Regulations 46, in effect since 1941. Since 1932 the law imposing the electrical energy tax has several times been reenacted, extended, or changed in other respects; but in no instance has this construction by the Treasury been disapproved; the brief for the Government in the Court below said (page 19) that "It must therefore be regarded as having been approved by Congress". The Regulation for separate treatment of the energy consumed at a single location where different uses are supplied through a single meter, and indeed the whole plan and scope of the Regulations, seem plainly to negative a test based

only on the nature of the consumer's predominant business at all locations.

We recognize that the Government has, as it admitted below in the present case, tried at times to sort out and tax as commercial some of the energy supplied to particular locations in businesses predominantly industrial,[3] and also to reclassify as "commercial" some instances of the use of energy in industry; but the very making of such an effort over years reflects a very different view of the Regulations from that given effect by the present ruling that all consumption of energy by a commercial consumer must as a matter of law be treated and taxed as "commercial".

The ruling of the Court of Appeals for the Seventh Circuit that, regardless of separate metering and differences in the purposes for which energy is consumed at different and possibly far distant locations or through separate meters at the same location, the test of taxability is the predominant character of the enterprise is directly contrary to that of the Court of Appeals for the Tenth

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[3] The brief for the Government in the Court below (page 19) stated what has been taking place as to sorting out and taxing as "commercial" some of the consumptions of energy which take place at some locations of predominantly industrial enterprises. The Government's brief said:

> "It is true the Treasury has at the same time attempted to carry out a difficult mandate of Congress to its full limits *by reaching out to find sales for commercial consumption* in sales to distinct recognizable branches or phases of businesses carrying on commercial activities *despite the fact that the overall predominant character of the entire legal entities might be characterized as industrial*, where such branches or phases have been geographically separated or separate adjuncts are not typical integral parts of such businesses and where the electricity sold to such branches or phases has been separately metered." (italics supplied)

Circuit, which held in *United States* v. *Public Service Company of Colorado*, 143 F. 2d 79, 82, that the consumption to which the energy is put at the particular location is controlling, rather than the predominant nature of the consumer's business at all locations, and specifically that the pasteurizing of milk by Colorado dairies and the consumption of energy in such pasteurizing were not in "the commercial phase of the dairying enterprise" but in an industrial processing and non-commercial activity of the dairies. The Government did not ask for certiorari to review this factual ruling in the Tenth Circuit, but presented the pasteurization question anew to the Seventh Circuit, on the basis of some Wisconsin dairies which it evidently regarded as preponderantly commercial.

Because the Consolidated Edison Company of New York, Inc., and its affiliated or System Companies in New York City and Westchester County pay about one-tenth of the electrical energy taxes and supply energy to many pasteurization plants of dairies in their territory and also to other non-commercial activities of many commercial consumers, this group of Companies desires to place before the Court the considerations stated in this memorandum. These Companies submit that, under the statute and the Regulations, *all* of the energy supplied by them to consumers whose business is predominantly commercial could not merely for that reason be classified as "commercial" *as a matter of law*.

Questions of fact as to the purpose and circumstances of use at particular locations are made controlling by the statute and the Regulations, which were based on the diversities and disparities obtaining in industries and businesses in different parts of the country. The Wisconsin dairies and pasteurization plants are not necessarily typical of those of all parts of the country. In Colorado the Court of Appeals held that the dairies' pasteurization plants are not a commercial phase of the

enterprise. In New York and Westchester County, different and factually distinguishable pasteurization plants and electric consumption in them, as compared with those of Wisconsin, would be shown in the tax suits brought by these Companies and pending in the District Courts.

These Companies refer to these factual diversities, but recognize that they are immaterial if all energy supplied to any dairy is "commercial" as a matter of law, and if any energy supplied to any activity of a predominantly commercial enterprise is "commercial" as a matter of law. So we discuss at this stage the questions of law which are well tendered by the Solicitor-General,[4] and shall also call

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[4] The Solicitor-General's formal statement, on page 2 of his Memorandum on the Petition for Certiorari, of the three questions which he regards as presented here, gives the issues fairly and clearly, except that his third question appears to us to be an important phase of the first question; and we therefore combine them. His first question is to the effect that the nature of the operation in which the energy is consumed should be disregarded as a matter of law, to give controlling effect to the predominant nature of the consumer's whole business. His second question treats all sales of energy to dairies for the pasteurization of milk as for "commercial" consumption as a matter of law because the business of the dairies is preponderantly "commercial." We may best denote the joinder of issues here by quoting the Solicitor-General's formulation of the three questions which he regards as implicit and basic in the decision of the Seventh Circuit:

> "1. Does 'commercial consumption' refer to the particular process in which the energy is used or does it refer to the nature of the business of the consumer to which the energy is sold, irrespective of the particular process in which it is used?
>
> "2. The District Court found and the Court of Appeals upheld the finding that sales of electrical energy to dairies which are principally fluid milk dealers were sales to commercial businesses and not to industrial businesses and hence held the energy

(Footnote continued on next page)

attention to the vast, complicated and costly reclassification of customers, consumption and billing which would be required as to many types of uses of energy if the decision below were upheld. Whether the proceeds of the tax for the Government would be increased or decreased by giving effect to the Court's radical alteration of the legislative basis for applying the tax could not here be forecast.

We indicate a few of the countless typical and actual instances of drastic reclassification which the present decision would entail after sixteen years of administration and collection of the tax under Regulations which have been deemed reasonably explicit and informative:

A large steel-producing corporation, with mills and plants in numerous States, has its general office building in New York City. Energy supplied to that building has long been classified and taxed as "commercial". As the predominant business of the corporation is industrial, should energy supplied to its office building be now ruled non-taxable?

A nationally-known chain-store, with outlets in many cities, has factories in various cities, where articles are

(Footnote continued)

was sold for commercial consumption. Should the sales of energy nevertheless be considered as being for other than commercial consumption if it can be found that a substantial part of the energy was used in pasteurization or bottling and similar preparations for the sale and delivery of the milk?

"3. Is the decision of the Court of Appeals that the character of the consumption of the energy depends upon the nature of the consuming business contrary to Section 316.190 of Treasury Regulations 46, which provides that where energy consumed at a given location is furnished through one meter, the predominant character of the business carried on at such location shall determine the classification of consumption for the purposes of the tax?"

made or processed for sale in its stores. The concern is predominantly commercial, but its factories are and have been treated as obviously "industrial," and taxed accordingly. Should the energy supplied to these factories be hereafter taxed as "commercial"?

Energy supplied to telephone, telegraph and railroad companies is non-taxable as for "industrial" consumption; energy supplied to branch offices of those concerns is taxed as "commercial". Should the energy supplied to those offices be now held non-taxable because supplied to predominantly industrial enterprises?

A nationally-known jewelry store on Fifth Avenue in New York City has its factory in New Jersey. Energy supplied to the factory is for industrial use; must it be reclassified and taxed as supplied to a predominantly commercial enterprise?

An electric appliance manufacturing concern, with many factories, has general offices and sales offices in New York City. Energy supplied to the offices is now taxed as "commercial". Should it now be relieved of taxes because the corporation is predominantly industrial?

Pursuant to Rule 27 of the General Rules of this Court, the parties hereto by their counsel have consented to the filing of this brief.

Argument

Section 3411(a) of the Internal Revenue Code taxes electric companies upon energy sold for "domestic or commercial" consumption but not upon energy sold for "industrial consumption" or other non-commercial consumption. The basic questions here are stated thus:

A. Does "commercial consumption" of the energy supplied take place as a matter of law wher-

ever the consumer is engaged in a business which is predominantly commercial; or should the nature of the operation in which the energy is used at the location supplied and the separate metering of the energy consumed as between commercial and non-commercial purposes determine the tax classification, consistently with the statute and Treasury Regulations?

B. Does not the decision of the Court of Appeals that the character of the consumption of energy depends as a matter of law upon only the predominant character of the consumer's business at all locations contravene Section 316.190 of Treasury Regulations 46, which gives effect to separate metering of energy for different uses, recognizes the non-taxability of energy consumed for industrial purposes, and provides that where the energy for different uses is supplied through only one meter, the predominant character of the business *at that location only* (not at all locations) shall determine the taxability of the energy sold through the one meter?

C. Does the fact that various dairy companies in Wisconsin were found to be predominantly "commercial" businesses mean and require that electrical energy sold to those dairies for consumption in milk pasteurization plants and processes shall be deemed *as a matter of law* to be sold for "commercial" consumption because sold for consumption in a plant of a dairy customer whose overall business is predominantly commercial? Irrespective of factual circumstances as to the plants, the operation, the metering and use of the energy, and the business predominantly carried on at the plants, is all of the energy sold for use in the pasteurization of milk by dairies anywhere in the United States, to be taxed as commercially consumed *as a matter of law* because it is

supplied to concerns whose business is predominantly (not exclusively) commercial?

Summary of Argument

It is the position of this group of taxpayers that

1. The Congress and the Treasury Regulations did not make or permit a determination that all of the energy consumed at a location (or at all locations) of a consumer is taxable as "commercial" to depend and be based solely, as a matter of law, on the fact that the consumer's business as a whole is predominantly commercial. Electrical energy is often supplied for other than "commercial" consumption at particular locations in businesses which are predominantly "commercial", even as energy is often supplied for "commercial" taxable consumption at locations in businesses which are predominantly industrial. The statute and the Regulations require that the nature of the operation in which the energy is consumed and (where different uses are not separately metered) the predominant character of the business *at the location* (not at *all* locations or the consumer's business as a whole) be given effect in determining what consumption is taxable as "commercial". The decision below as to the proper test and method for determining what use of energy is taxable is inconsistent with the statute and contrary to Section 316.190 of Treasury Regulations 46 (quoted on pages 26-27, *infra*), and would impose a vast, complicated and costly reclassification of consumers and consumption, of dubious gain to the Government or taxpayers.

2. The finding below that the sales of energy to dairies for use in their pasteurization plants were sales to dairies which are commercial enterprises, and that "*hence*" the energy should as a matter of

law be treated as sold for "commercial" consumption, regardless of the facts as to its meterization and use and as to the predominant character of the dairies' business at the particular location, is repugnant to the statute and the Regulations. The particular facts as to the metering, the other uses of energy at the location through one or separate meters, and the predominant character of the business *at the location* (if "commercial" and non-commercial uses are not separately metered), are explicitly required to be given effect and could not be cast aside in favor of a test which is in no way indicated, and is at many points expressly negatived, in the Regulations.

I

The Congress and the Treasury regulations did not make and do not permit a determination that all of the energy supplied to a consumer at a location is taxable as sold for "commercial" consumption as a matter of law for the reason that it is supplied to a consumer whose business as a whole is predominantly "commercial" in character.

Section 616 (a) of the Revenue Act of 1932 and the Treasury Regulations which have been in effect ever since did not and do not provide or intend that electrical energy supplied at a location to a consumer whose *total* business at all locations is predominantly commercial shall on that account be taxed as "commercial". The taxability of the consumption of energy was not made to depend on the predominant character of the overall business of which it is a part. The statute and the Regulations seem to us so plainly to repudiate as the test the predominant character of the business as a whole that examination of the legislative record as to the intent of the Congress is unnecessary.

Yet, if made, an inquiry as to the origins of the statute and the Regulations leaves no doubt as to the intent. A great deal took place before the tax on electrical energy was imposed in its present form in 1932; and that history, well known to the Commissioner and the Treasury at the time and taken into account in the wording of the statute and the Regulations, seems to us to confirm that the decision below is unsupportable. The taxing of electrical energy was avowedly a part of a program for obtaining more tax revenues. The first assumption and proposal were that it was practicable to tax all sales of energy for consumption, and to have the electric companies assess, bill and collect the tax from their consumers. It was found that, in fairness and practicability, the tax could not be imposed on large uses of energy where a privately-owned plant (untaxable) might compete with a regulated (and taxed) public utility. So it was sought to obtain revenue by having the company assess and collect the energy tax from "domestic or commercial" uses of energy, in dwellings, retail stores and shops, small sales concerns, etc.[5] Actually, the intent which

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[5] Terms such as "domestic or commercial" and "industrial" (and "industrial or other") were put in the statute as guide for later defining the intended boundaries between taxability and non-taxability of particular *consumption*. These were not regarded as definitive in the electrical industry or as used in the dictionary sense of words. Definition by Regulations was required. "Industrial" was obviously much broader than "manufacturing" or "wholesale". The Regulations contemporaneous with the 1932 statute specifically included as also "industrial" the consumption of energy for many purposes obviously "commercial" in any ordinary sense, such as railroads, telegraph, telephone and radio, and other public utilities, along with mining, refining, irrigation, educational institutions not operated for profit, churches and charitable institutions (Article 40, Regulations 42 as amended; Section 316.190, Regulations 46 as amended). The exemption from taxation was referred to as of energy supplied for consumption for "industrial or

(Footnote continued on next page)

finally found expression in the law and the Regulations was that only *small* commercial consumption could be taxed, along with the domestic. The Regulations quickly freed from the tax many types of large commercial use, as well as "industrial or other businesses". A multiplicity of references to 1932-33 proceedings in the Congress could be cited to demonstrate this legislative intent. On this basis, Section 616(a) of the Revenue Act of 1932 was enacted, in a wording which is still in effect aside from a change in the percentage of the tax (See Appendix, page 25, *post*).

The Treasury Regulations, as initially issued and as still in effect, were palpably and explicitly based on the nature and purpose of the *consumption* at the meter and location billed, not the general nature of the consumer's business at all locations. The electric companies were to compute the tax on such energy as was sold for commercial consumption at a meter or location, put it on their bills for each unit, and collect and pay over the proceeds. The companies knew, from their inspections, etc., the nature of the consumption of energy at a meter and location in their territory; but their billing of the tax obviously could not be based on the predominant character of the consumer's business, perhaps carried on in many States.

As probably was foreseen, the projected tax to be paid *by consumers*, upon the specified types of their *consumption* of energy, was transmuted in 1933 into a tax to be paid by the *vendors* of the energy; but the form and basis of the

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(Footnote continued)

other businesses". But to this was added the further proviso, which seems to be decisively against the decision below and the Government's apparent contention here; viz., the proviso for the taxability nevertheless of such energy as is sold "*for consumption in commercial phases of industrial or other businesses*", with apposite instances of "commercial" consumption on "industrial" premises given in Article 40, Regulations 42 as amended.

tax, and the Regulations, were retained.[6] Ever since the enactment of the tax in its present form in 1932, the Regulations, interpretations, and generally the rulings, have conformed to the statute by treating as taxable only such energy as was sold for "domestic or commercial consumption", with the particular location or the separate meter as the unit for determining the nature or purpose of the use of the energy supplied to it—not the nature of the overall business of the consumer, at all his locations.

Ever since the original enactment of the tax, the Regulations have been contrary to determining the nature of the consumption of energy by the overall character of the consumer's business. Its applicability to "energy sold to a consumer for two or more purposes, through separate meters" (as is usually the case) has been determined, from the first, by "the specific use for which the energy is sold through each meter; i.e., whether for domestic or commercial consumption, or for other use" (T. R. 42 of 1932; Art. 40 as amended by T. D. 4393; T. R. 46 of 1940, Section 316.190 as added by T. D. 5099). Regardless of the overall nature of the consumer's business at its various locations or the predominant character of the business done at the particular location, the test of the taxability of the energy sold through a meter (or through several meters combined for billing purposes) was "the specific use" for which that energy was sold. The decision below, to the effect that the overall nature of the consumer's business at all locations determines the nature of the consumption at each and every location, is rejected by the Treasury Regulations since 1932

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[6] Mr. Whittington, the author of the 1933 amendment which was enacted, testified before the Senate Finance Committee that the amendment "does one thing and one thing alone: It transfers this tax from the consumer to the vendor". The statements on the floor of the Senate and House, at the time of the adoption of the Conference report, were to like effect (77 *Cong. Record* 5463-65, -66, and -67).

that if the use of energy at a location is for two or more purposes (one of them taxable), and if

> "the consumer has all the electrical energy consumed at a given location furnished through one meter, the *predominant character* of the business carried on *at such location* shall determine the classification of consumption for the purposes of this tax" (T. R. 42 of 1932; Art. 40 as amended by T. D. 4393). (italics supplied)

The Regulations in force since 1932 have left no doubt of these *criteria*, which the decision at bar rejects and contravenes. If "industrial or other businesses" have "commercial" phases, "such as in office buildings, sales and display rooms, retail stores", etc., the energy sold for consumption in such "commercial activities" is taxable (T. R. 46; Section 316.190), even though the consumer's whole business is predominantly "industrial" or non-commercial. If a commercial enterprise such as a department store owns and operates a manufacturing plant at another location, the energy supplied to the plant is exempt as for industrial consumption. The Bureau has consistently held that if a bakery enterprise has its retail store in the front of its property and its bakery in the rear, the energy supplied may be separately metered and the energy consumed in the bakery is non-taxable.

T. D. 4342 and 4393 have not been changed in substance from 1932 to date; the Congress has on five occasions reenacted, extended or amended in other respects the taxing statute; and the Court of Appeals for the Tenth Circuit has held, *without an application by the Government for certiorari*, that the consumption to which the energy is put at the particular location is controlling, rather than the overall nature of the customer's business at all locations, even where the overall business is commercial (*United States* v. *Public Service Company of Colorado*, 143 F. 2d 79, 82).

On the other hand, in *St. Louis Refrigerating and Cold Storage Co.* v. *United States*, 43 F. Supp. 476, the taxpayer's consumption of energy was in the manufacture and sale of ice, the sale and distribution of refrigeration through pipe lines to numerous customers, and the providing of refrigeration for its warehouses in various parts of the city. The various phases of the business were thus commingled. Of the taxpayer's activities, the Court said in its findings (page 480):

> "Electrical energy used in the manufacture of ice for sale is not subject to the tax if separately metered."

The Court said (page 483):

> " * * * No separate meter was maintained for the part that was industrial and there is no satisfactory showing as to the amount of electrical energy consumed in that phase of the business."

In the *St. Louis Refrigerating* case, the taxpayer's business being thus predominantly commercial at each location, with no separate metering of the energy used for non-commercial purposes, the taxpayer's total consumption of energy was held to be taxable. This ruling stops far short of holding that the overall commercial character of a customer's business should be imputed to consumptions of energy through separate meters for "industrial" uses or at locations where the "commercial" activities are slight if any.

Uncertainty and Confusion Would Result from the Enforced Reclassifications of Consumptions

We think it would be idle to suggest or seek that the broad grounds of decision by the Court below, for the classification of each consumption of electrical energy according to the predominant character of the consumer's overall business at all his locations rather than the nature and purpose of the consumption at the particular location or through the particular meter, were or could be limited

to cases involving the pasteurization of milk. The Solicitor-General in his Memorandum for the Government on the Petition for Certiorari here put his contention on no such limited ground (page 7). If the Seventh Circuit's test based on ascertaining the predominant nature of the consumer's business—in disregard of the nature of the activities served by the meter and the energy supplied through it—were now sustained, a complete reclassification of "commercial" and "industrial" electrical consumers throughout the United States would be inescapable.

The decision in the Seventh Circuit would overturn the administrative rulings and practice which have obtained since 1932 and would compel, in the territory of virtually every electric company, a vast and costly reclassifications of customers and changes in the billing of the tax. Whether the outcome would be gain or loss to the Government we could not forecast. There are many instances where the energy supplied is not now deemed taxable because it is for non-commercial uses at the particular location although the customer's predominant business in the United States as a whole is commercial. On the other hand, there are many instances where the energy supplied is now deemed taxable (e.g., that to a New York City office or sales building of a national manufacturing concern) but would not be taxable if the criterion declared by the Seventh Circuit were sustained; e.g., the predominant character of the customer's business at all locations.

The proposed new test of commercial character would be hard to classify and apply. The nature and purpose of the use of electricity through a meter at a location are reasonably ascertainable, through inspections, etc. For an electric company in one city to find out whether the business of, say, a national concern or one having establishments in several States is predominantly "commercial" or "industrial", would not be easy. All sorts of questions as to operations, finances, output, profits, etc., might have to be

explored. This the billing electric company could not readily do.

In a sense, the activities of practically every industry and business have a "commercial" aspect, in that they are to eventuate in sales; but as to the applicability of this tax, the Congress and the Commissioner carved out large areas of activities—many of them consisting of the very essence of *commerce*[7]—and classified them as "industrial" or other businesses so that they would not be taxable. Even then, the test has been the nature and purpose of the *consumption* of the energy supplied through the particular meter or at the particular location—not the overall general character of the customer's business.[8]

We think that a statute taxing certain *uses and consumption* of electrical energy is contravened by making the overall character of the customer's business necessarily controlling as to the kind of consumption at all of his locations. Legislative intent need hardly be inquired into, but the evidences are clear that the tax was thought of as being imposed on energy consumed in dwellings, stores and shops, and not on industrial concerns or uses. "Commercial phases of industrial or other businesses", to be separated and taxed, were specified in the Regulations as including such uses as in "office buildings, sales and display rooms, retail stores, etc."

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[7] Such as railroads, telegraphs, telephones, converting, refining, transporting, etc. (Section 316.190 of Regulations 46 as amended by T. D. 5099). The exemption was described as of energy consumed in "industrial or other businesses".

[8] Thus the energy supplied to a telegraph or telephone system is "industrial", but the energy supplied to one of their branch offices is "commercial". The energy supplied to general or business offices of large manufacturing concerns is "commercial". The energy supplied to a bakery is exempt as "industrial"; that supplied to its store or retail outlet, in front of the same property, is separately metered and taxed as "commercial".

The long-established practice in the electric business and the contemporaneous construction in 1932 and 1933 by those charged with the federal taxing of electrical consumption and responsible for the plan embodied in the Treasury Regulations, generally to treat each meter or location of a customer as a customer and to inspect and ascertain the nature of the use of energy at that location and apply the tax accordingly, should not be upset except for weighty reasons.

Commissioner of Internal Revenue v. *South Texas Lumber Company*, 333 U. S. 496, 500-501 (1948).

II

Consumption of electrical energy in dairy plants engaged in the pasteurization of milk does not become consumption for "commercial" purposes for the reason that the business of the dairies is predominantly "commercial".

We believe that we have shown that the Court below applied the wrong test and arrived at its conclusion on untenable grounds, as to the pasteurization plants. The Court was of the opinion that *since* the business of the dairy concerns as a whole is predominantly "commercial" from the purchase of the raw milk to the distribution and sale of the pasteurized or homogenized milk or milk products, *therefore* the energy supplied to the dairies at any location and for any purpose is necessarily for "commercial" consumption, for purposes of the taxing statute. If this construction were right, none of the energy supplied at any location or for any use, to a predominantly industrial concern (e.g., to its general office, its sales office, or its sales warehouses), would be taxable; and all of the energy sold to any location of a predominantly commercial concern would be taxable, even though the separate location is

devoted exclusively to manufacturing or other "industrial" uses. We have shown that this has never been in the Regulations or the practice as to this tax on energy.

There has been no intimation in the Congress of an intention to impose the tax on energy sold for operations such as pasteurization plants. The Congress, by five separate provisions over a period of nine years, has either re-enacted, extended or amended the statute without changing the language which the Regulations construed. Congress did not depart from what Senator Pat Harrison had said in 1933, that the tax was imposed only on "energy used in stores and dwellings that are classified as commercial and domestic" (77 *Cong. Record* 3213). No tax was to be imposed on "electrical energy used in *industry*." Senator Reed said that the 1932 law and its classification "means that we shall get our revenue out of electricity sold to shops and offices and places of that sort" (75 *Cong. Record*, page 11608). There is nothing which we understand as shops or stores or offices in connection with these pasteurization plants; any sales activities at the plants are minor and incidental, not preponderant.

So far as the plants in the present record are concerned, only one has at its location any accessory activity that could reasonably be classified as commercial. The buying and picking up of the raw milk, the selling and delivery of the pasteurized milk, the collections for the milk sold, the management, the commercial accounting, etc., take place off the premises of these plants.

Fifteen of the twenty-eight plants are supplied through more than one meter, but apparently for the purpose of obtaining the three-phase energy required for their large operations. The activities that could be deemed of possibly a "commercial" character are so slight in extent that they are not separately metered, as could readily be done, as authorized by the Regulations.

The Court of Appeals for the Tenth Circuit held in the *Public Service Company of Colorado* case that energy supplied to pasteurization plants was for *industrial*, not commercial consumption, and that this was unaffected by the 1941 removal of the word "processing" from the Regulations. The Commissioner did not ask for a writ of certiorari to challenge this decision. Outside the Tenth Circuit the Commissioner has lately tried to have pasteurization treated as a part of the commercial operations in dairies. The Supreme Court of Michigan held the pasteurization of milk to be a part of industrial processing (*Michigan Allied Dairy Association* v. *Auditor General*, 302 Mich. 643; 5 N. W. 2nd 516, 517-18). Actually, the excision of the word "processing" was evidently meant to lessen the ground for the exemption of various small-scale operations which hardly amounted to "processing" but were claimed to be such. Instances are the coloring of oranges, the filtering and bottling of olive oil, the bottling of spring water with or without additives. The pasteurization of milk as a skilled operation requiring large space and large amounts of heavy-duty machinery is plainly an "industrial" operation, to prepare and condition the raw milk and conform it to laws or ordinances governing its sale and distribution.

What is done in such a pasteurization plant, by way of preparing its product and putting it in form for sales and deliveries at other locations, is not a part of the *selling* but is a part of the "*industrial*" activity precedent to the "commercial" activity in preparing the product and putting it in form and content readily salable—not in selling it. Heavy-duty machinery, special skills and experience, large floor space devoted only to the pasteurization, are required in such plants. The activity is aptly characterized only as "industrial", and to characterize as merely "commercial" or "sales" this material and essential conversion of raw material into a salable product is to ignore the clear Congressional intent that industrial and related plant uses of energy should not be taxed.

Conclusion

If the Congress or the Commissioner intended to make the tax applicable as a matter of law to *all* of the energy supplied to all commercial *consumers*, irrespective of the use made of the energy, and not merely to such *consumption* as is "commercial" in nature and purpose, they could readily and clearly have said so.

If the Commissioner had believed that the statute called on him to classify *consumers rather than consumption* and to exempt from taxation all energy supplied for commercial consumption by a consumer predominantly "industrial" in its overall business, the Regulations would doubtless have been so written.

The decision of the Court of Appeals for the Seventh Circuit, subjecting to tax the energy supplied to the pasteurization plants of dairies, was based on an assumption that the predominant character of the overall business of the *consumer*, rather than the nature and purpose of the consumption at the particular locations, should be made to determine and control as a matter of law the taxability of *all* of the energy supplied to a commercial consumer. That assumption was erroneous, and the ruling for the tax should be set aside.

After full inquiry into the facts called for by the Regulations, energy sold for consumption in the pasteurization of milk is held in the Tenth Circuit to be sold for non-commercial purposes which are non-taxable under the Regulations. Pasteurization of milk was held in the Tenth Circuit to involve no "commercial" consumption of energy. In the Seventh Circuit, from an erroneous conclusion that all energy supplied to any location of a predominantly commercial business is for "commercial" consumption as a matter of law, the Court concluded that "hence" the energy

supplied to any pasteurization plant of a dairy is necessarily for "commercial" consumption.

We urge that unless and until the Congress changes the bases of the energy tax, its application and administration may best be left to proceed and be determined according to the reasonable and factual inquiries and criteria which have been set up by the Regulations from the inception of the tax.

New York, November 24, 1948.

Respectfully submitted

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APPENDIX

Internal Revenue Code:

> SEC. 3411. TAX ON ELECTRICAL ENERGY FOR DOMESTIC OR COMMERCIAL CONSUMPTION.
>
> (a) There shall be imposed upon electrical energy sold for domestic or commercial consumption and not for resale a tax equivalent to 3 per centum of the price for which so sold, to be paid by the vendor under such rules and regulations as the Commissioner, with the approval of the Secretary, shall prescribe. The sale of electrical energy to an owner or lessee of a building, who purchases such electrical energy for resale to the tenants therein, shall for the purposes of this section be considered as a sale for consumption and not for resale, but the resale to the tenant shall not be considered a sale for consumption. • • •
>
> (26 U. S. C 1946 ed., Sec. 3411.)

Section 616 (a) had been enacted in 1932 to impose the tax upon electrical energy sold for "domestic or commercial consumption," but to be paid by the consumers. In 1933 this was amended as above, to provide for payment of the tax by the vendors of the energy. The Treasury Regulations under the 1932 law were not changed under the 1933 legislation. After the promulgation of the 1932 Regulations, the taxing provisions were on five different occasions re-enacted, extended or amended in other respects, by the Congress, without disapproval of or change in the Regulations.

Section 3411 (a) was amended by the Revenue Act of 1941, c. 412, 55 Stat. 687, Sec. 521(a) (19), to change the three per cent tax to three and one-third per cent, but the section was left otherwise the same.

Treasury Regulations 42, promulgated under the Revenue Act of 1932:

Art. 39 [as amended by T. D. 4922, 1939-2 Cum. Bull. 363]. *Effective period.*—The tax applies to electrical energy sold prior to July 1, 1941.

Art. 40 [as amended by T. D. 4393, XII-Cum-Bull. 322 (1933)]. *Scope of tax.*—The tax is imposed upon electrical energy sold for domestic or commercial consumption and not for resale, except as provided hereinafter.

The term "electrical energy sold for domestic or commercial consumption" does not include (1) electrical energy sold for industrial consumption, e. g., for use in manufacturing, processing, mining, refining, shipbuilding, building construction, irrigation, etc., or (2) that sold for other uses which likewise can not be classed as domestic or commercial, such as the electrical energy used by public utilities, waterworks, telegraph, telephone, and radio communication companies, railroads, other common carriers, educational institutions not operated for profit, churches, and charitable institutions. However, electrical energy is subject to tax if sold for use in the commercial phases of industrial or other businesses, such as in office buildings, sales and display rooms, retail stores, etc.

Where electrical energy is sold to a single consumer for two or more purposes, through separate meters, the specific use for which the energy is sold through each meter, i. e., whether for domestic or commercial consumption, or for other use, shall determine its taxable status. Where the consumer has all the electrical energy used at a given location furnished through one meter, the predominant character of the business carried on at such location shall determine the classification of consumption for the purposes of this tax.

Treasury Regulations 46 (1940 ed.):

Sec. 316.190 [as added by T. D. 5099, 1941-2 Cum. Bull. 267]. *Scope of tax.*—The tax imposed by section 3411 (a) of the Internal Revenue Code, as

amended, applies, except as provided hereinafter, to all electrical energy sold for domestic or commercial consumption and not for resale.

The term "electrical energy sold for domestic or commercial consumption" does not include (1) electrical energy sold for industrial consumption, e.g., for use in manufacturing, mining, refining, shipbuilding, building construction, irrigation, etc., or (2) that sold for other uses which likewise can not be classed as domestic or commercial, such as the electrical energy used by electric and gas companies, waterworks, telegraph, telephone, and radio communication companies, railroads, other similar common carriers, educational institutions not operated for private profit, churches, and charitable institutions in their operations as such. However, electrical energy is subject to tax if sold for consumption in commercial phases of industrial or other businesses, such as in office buildings, sales and display rooms, retail stores, etc., or in domestic phases, such as in dormitories or living quarters maintained by educational institutions, churches, charitable institutions, or others.

Where electrical energy is sold to a consumer for two or more purposes, through separate meters, the specific use for which the energy is sold through each meter, i.e., whether for domestic or commercial consumption, or for other use, shall determine its taxable status. Where the consumer has all the electrical energy consumed at a given location furnished through one meter, the predominant character of the business carried on at such location shall determine the classification of consumption for the purposes of this tax.

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